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SIPDIS

SENSITIVE

DEPT FOR EB/IFD, WHA/CAN AND WHA/EPSC
STATE PASS CEA FOR Randy Kroszner, FRB FOR C. BERTAUT
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TREASURY FOR OASIA/IMI - HARLOW, MATHIEU
USDOC FOR 4320/MAC/ON/OIA/JBENDER
PARIS ALSO FOR USOECD
CALGARY PASS TO WINNIPEG

E.O. 12958: N/A

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SUBJECT: CANADA'S FEDERAL BUDGET: PM CHRETIEEN'S LEGACY --
"JEAN BILLIONAIRE"!

REF: (A) Ottawa 2711 (B) Ottawa 3113

[11.](#) (U) Sensitive but unclassified, please protect accordingly. Not for Internet distribution.

Summary

[12.](#) (SBU) Dubbed Prime Minister Jean Chretien's "Legacy" by Canadian analysts, the budget presented on February 18 is the largest fiscal stimulus package since the Trudeau era 20 years ago, and the second largest spending program in 40 years. The "Jean Billionaire Budget", with C\$14.3 billion this year (FY03-04), and C\$38 billion over the next five years, includes something for almost everyone but few surprises. (Note: using an exchange rate of 1C\$ = 66 UScents, new spending FY2003-2004 would be US\$9.4 billion and over five years, US\$25.1 billion.) Despite the 11.5% increase in spending (four times the rate of inflation) this is the GOC's sixth consecutive balanced budget and does provide for debt reduction.

[13.](#) (U) Finance Minister John Manley was able to use his first budget as a launching pad in his bid to succeed Prime Minister Chretien. (Chretien has announced that he will step down in February 2004.) In his speech to Parliament, Manley stressed benefits for children, the homeless and First Nations (aboriginal) communities, saying "you can't have a world of peace unless you address the world of need." His speech emphasized commitment to making Canada a knowledge economy, and expressed the wish that the maple leaf, wherever it is seen in the world, will represent hope, compassion and determination. Manley also promised a thorough review of government programs and expects to reallocate C\$1 billion a year to higher priority programs on a continuing basis.

The Lion's Share for Health Care: 63%

[14.](#) (SBU) As indicated in the Speech from the Throne (ref A) and called for in the November 2002 Romanow Report, health care spending takes the lion's share of the budget. Spending is slated to increase by C\$34.8 billion over the next five years - C\$8.96 billion this year alone - for 63 percent of total new spending of C\$14.3 billion this fiscal year. Defense spending, in contrast, receives 0.8% of this year's spending, for a total of C\$1.1 billion. Although the increase in defense spending is less than some had hoped, it reverses years of significant declines and is a big step in the right direction for Canada's military. End Summary.

[15.](#) (SBU) Comment: As in past years, the GOC intentionally leaked many budget proposals. Financial markets had discounted the GOC's spending, and the Canadian dollar remained stable. Some analysts contend that the markets will ignore this budget because it can be viewed as "just a one-year change in policy" until the end of Chretien's tenure. With the generous spending to support the Prime Minister's swan song "wish list," Finance Minister Manley was able maintain Canada's image of fiscal prudence only in comparison to the fiscal deterioration of the rest of the G7. End Comment.

Budget Overview: Risks are from the U.S.

[16.](#) (U) Economic Assumptions:
-- 3.2% real GDP growth in 2003 (highest in the G7)
-- 3.5% real GDP growth in 2004
-- Risks include uncertain economic recovery in the U.S. and geopolitical concerns, especially possible war in Iraq.

[17.](#) (U) Fiscal Projections: The Sun Will Keep Shining

-- Canada is the only G7 country to record a surplus in FY2000-2001 (C\$15B) and FY2001-2002 (C\$8.2B). The Liberal Party is committed to "balanced budgets or beyond" from this year (FY2002-2003) through FY2004-2005, a promise that has traditionally resulted in surpluses.

-- Debt reduction payments of C\$47.6 billion in FY2001-2002 lowered the federal debt-to-GDP ratio to 46.5%, from 51.8% in the previous year. (The debt-to-GDP ratio is projected to drop to 40% by FY2004-2005.)

-- The GOC's Contingency Reserve will remain at \$3 billion, while "Economic Prudence" will rise to C\$1 billion in this fiscal year and C\$2 billion next fiscal year, from zero the past two years. Note: Economic Prudence is a reserve set aside for unforeseen factors that could undermine economic performance, such as global political and economic uncertainties. No funds were needed for "Economic Prudence" in the previous two fiscal years because the Canadian economy performed above expectations. End note.

18. (U) Spending Initiatives: Something For Everyone

Total new spending of C\$25 billion over three years covers most sectors, although some, such as health care, have five-year spending commitments or longer.

Health Care and Other Social Spending

-- The C\$34.8 billion committed for increased spending in health care over five years includes:

-- A five-year C\$16 billion Health Reform Fund for the provinces and territories to target primary health care, home care and catastrophic drug coverage.

-- A C\$9.5 billion increase in cash transfers to the provinces and territories over five years.

-- An immediate investment of C\$2.5 billion through the Canada Health and Social Transfer supplement (with details left to the discretion of the respective provinces).

-- C\$5.5 billion in health reform initiatives, including diagnostic/medical equipment and a six-week compassionate leave benefit under employment insurance.

-- C\$1.3 billion to support First Nations' health programs.

-- C\$5.6 billion in social spending for the homeless, childcare, and affordable housing.

Defense, Security, Foreign Aid: Reversing decline

-- An increase of C\$800 million for Canadian military capabilities in each of the next three years. (Note: in his speech, the FinMin said "every year," without specifying a time limit. End note.)

-- C\$170 million this fiscal year for urgent capital requirements, maintenance of capital equipment, spare parts, the purchase of new capital equipment and other expenses.

-- C\$100 million to support the military commitment in Afghanistan ("Operation Apollo").

-- C\$75 million in each of the next two years for the Security Contingency Reserve, to enable the GOC to respond to unforeseen security needs, including border security.

-- Nearly C\$500 million annually in foreign aid (an 8% increase), for a total of C\$1.4 billion over the next three fiscal years.

Sustainable Development (including Kyoto implementation): Still Vague

The budget allocates C\$3 billion to environmental initiatives, including:

-- C\$2 billion over five years to implement the Kyoto Accord;

-- C\$1 billion for other environmental measures.

Note: There are still no details on how the Kyoto implementation funds will be spent. End note

Refining the Tax System

Manley prefaced his comments on tax changes by saying this budget supports improved corporate governance and regulation. The budget will:

-- Reduce the corporate tax rate to 21% from 28% over the next five years while making other changes to the corporate tax structure.

-- Reduce the tax on resource income to 21% over five years.

-- Raise RRSP and RRP (pension plan) contribution limits to C\$18,000 over four years, and index the new limits.

-- Eliminate the federal capital tax over the next five years, with medium-sized businesses benefiting first. (Initially, the capital threshold at which the tax applies will be raised from C\$10 million to C\$50 million effective in January 2004. As of January 2004, medium-sized businesses under the C\$50 million threshold will no longer have to pay the tax. Second, the rate of the tax will be reduced in stages over a period of five years so that by 2008, the tax will be completely eliminated. No changes are proposed to the special capital tax on large financial institutions.)

-- Reduce the airport security tax from C\$24 to C\$14 per round trip after March 1.

-- Increase the film and video production services tax credit from 11% to 16% of qualified Canadian labor expenditures. The GOC will continue to consult with the Canadian film industry to develop criteria for a streamlined mechanism for delivering the tax credit, which in turn could provide a refundable tax credit of 25% of qualified labor expenditures for Canadian film or video productions.

Other items

-- C\$2 billion has been earmarked for "innovation and skills," such as research grants and scholarships. Manley highlighted in his speech that this year a greater proportion of scholarships will support social science scholars. He also stressed the allocation of C\$114.5 million over 5 years to support dual language proficiency.

-- C\$5.2 billion over six years in farm aid
Cellucci